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Ethics 2017

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- Attorneys employed by a title insurance agent licensed with Stewart Title Guaranty or Stewart entities
- Fee attorneys who have an Escrow Officer license through a Stewart Title Agent or Stewart entity

We welcome any other lawyers to listen, but cannot provide continuing education credit to you.



Stewart Legal Services

Ethics Review 2017

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Ethics

"In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don't have the first, the other two will kill you." -- Warren Buffet



Ethics

A set of principles that govern the conduct of a person or in our case, members of our profession

Set includes: what is permitted by law and rules

what is right, moral, legitimate

what is best for the *customer*

You may have the *right to lawfully* do something, but it may not be the *right thing to do* under the circumstances....



I. The Proper Rate Rule – Basic rules

Title companies must issue policies, endorsements, and other forms pursuant to the applicable Rate Rules promulgated by the Commissioner of Insurance - no deviation

Choice of which Rate Rule applies and interpretation of Rate Rules is complicated!

Choice between 2 applicable rates needs to be resolved in favor of the customer... within the rules as written.

Has been a point of contention by TDI; has been an area that is flagged for audits. Why? Historically, premium rates charged by insurers have been the subject of litigation - class action lawsuits.



I. The Proper Rate Rule: Too Strict?

Ex. R-8 Mortgagee Policy on a Loan to Fully take up, Renew, Extend or Satisfy an Existing Lien(s)

“On a Mortgagee Policy, issued on a loan to fully take up, renew, extend or satisfy an old mortgage(s) that is already insured by a Mortgagee Policy(ies), the new policy being in the amount of the note of the new mortgage, the premium for the new policy shall be at the Basic Rate, but a credit shall reduce the premium by the following amount:” ...

- New policy is for the Basic Rate on amount of the note of the new mortgage, but a credit is given to reduce the premium by % set forth in the schedule, depending on the age of prior policy.
- Allows premium credits for up to 7 years prior.



I. The Proper Rate Rule: Too Strict?

R-8 Mortgagee Policy on a Loan to Fully take up, Renew, Extend or Satisfy an Existing Mortgage(s)

In the past, stricter limitations (deviations) were imposed in applying R-8:

Didn't apply it to **Home Equity Loans**

Didn't apply it when the new loan was to fully take up **several prior mortgages** at once

Didn't apply it where the prior mortgage was **insured by another insurer**

Look at the language of R-8. These limitations are not in R-8.



I. The Proper Rate Rule: Too Loose?

R-1: Cannot use a combination of rate rules to calculate premium unless the Basic Rate on the policy in the largest amount is charged...

Example:

- Under Rate Rule R-3, an owner may turn in his or her prior owner policy after adding improvements to the land and receive *a credit for the cost of the prior policy* towards the cost of the new owner policy, BUT
- may not *also* secure a new simultaneous mortgagee policy under Rate Rule R-5A (\$100) at that time.



I. The Proper Rate Rule: Which One?

R-8 vs. R-18 credit

R-8 is for Mortgagee Policy on a Loan to Fully take up, Renew, Extend or Satisfy an Existing Mortgage(s)

- New policy is for the basic rate on amount of the note of the mortgage, but a credit is given to reduce the premium **by %** set forth in the schedule, depending on the age of prior policy
- Allows premium credits for up to 7 years prior.

R-18 is for Mortgagee Policy on a Loan to Fully take up, Renew, Extend or Satisfy Existing Mortgage(s) **involving a Construction Loan with P-8 exceptions**

- If new mortgage policy is NOT greater than old policy, charge Basic Rate on new policy
- If new mortgage policy is greater, must compute Basic Rate on new policy, then subtract *entire* premium charged on the old policy as credit to reduce the premium on the new policy.
- No time limit for giving credit.

Which one benefits the customer most?



II. Property Descriptions and Surveys

When we insure title to a property, the **description of the property** is critical. Each property must be described in a way to set it apart from all other properties.

Legal Descriptions are to lots and blocks in subdivisions or to metes and bounds descriptions. Basic idea is to be able to locate the property boundaries and any related matters based on the description given.

Descriptions should be created by *a registered surveyor*. As a general rule, descriptions by non-professionals can be dangerous and should not be relied upon.



II. Property Descriptions and Surveys

Title policies except to certain things, such a *boundary line discrepancies and encroachments by improvements and easements*.

To amend these exceptions, we must have an *acceptable survey* or *evidence of a survey*. To be *acceptable*, the survey must be specific enough to address the issues set out in the exception(s) being deleted.

In a perfect world, we get to see a recent survey = usually 6 months old or less.

BUT Surveys are expensive and time consuming...



II. Surveys – Old vs. Current

Rule P-2 (Area and Boundaries Amendment) allows us to rely on older surveys, made for any party in the chain of title to consider amending the standard area and boundaries exception.

On a residential transactions, (and commercial transactions up to \$10 million), you can accept a survey or evidence of a survey of any age if you get an Owner's Survey Affidavit confirming the status of the boundaries and improvements to the property and evidence of the existing real property survey (aka, the T-47).

For **refinance** deals, under P-2 must use a survey no older than *7 years* - ... if no changes have been made to the improvements.

See STG Bulletin TX-000062 for details.



II. Surveys – Old vs. Current

Technology enhances our ability to assess survey information, but can also create ethical dilemmas...

Example:

Seller produces a 4 year old survey, and provides a T-47 verifying no new improvements/ changes have been made since the survey was made.

You look up the property on an internet website, and you see there is a tool shed not listed on the prior survey or the T-47, that appears to be over the back boundary line.

Knowledge: Since you now know about it, you have a duty to inquire about the shed with the customer. Maybe he forgot about it; maybe he did not want to draw attention to it. You must inquire about it, maybe inspect if not sure about it.



III. What to do in case of an Escrow Dispute

Fiduciary Duties are imposed on the Escrow Agent.

Escrow Agent is a neutral third party who owes a **fiduciary duty to all parties** to the escrow agreement. As fiduciary, you must act with utmost good faith for both sides at the same time.

Highest standard of confidence, trust, and good faith

Keep in mind that escrow issues are generally beyond the scope of your underwriting agreement – so you are on your own....



III. Duties imposed on an Escrow Agent

a. Impartiality - Avoiding Conflicts of Interest

Avoid self-dealing.

Avoid taking instructions from just one party to the transaction.

Avoid instructions that call on you to make any judgments.

b. Duty of Full Disclosure

Disclosure only – not to give advice, especially not legal advice...

Fraud - If you have *actual knowledge* of facts that present substantial evidence of fraud, you must disclose.

Flip Transactions - no general duty to disclose unless disbursement instructions require, BUT if you know or reasonably suspect something is amiss...



III. Duties imposed on an Escrow Agent

c. Duty of Confidentiality

Some things should **not** be disclosed. Review closing instructions for *definitions on “confidentiality”* as to that particular closing.

- Gramm-Leach-Bliley Act, and CFPB: **Personally Identifiable Non-Public Information** (NPI) of consumers in non-commercial transactions

d. Duty of Care of Escrowed Moneys

Duty to exercise a high degree of care to conserve earnest money and pay only to those entitled as instructed.

P-27 B, Tex. Ins. Code Sec. 2651.202 - “Good Funds” Rule - in amount equal to all disbursements must be received, recorded and deposited **BEFORE** any disbursement may be made.

No partial disbursements prior to receipt and deposit of good funds, ever



III. What to do in case of an Escrow Dispute

Seller and Buyer come to you with a new transaction. Buyer deposits earnest money in escrow with you as per contract. Before you close, Buyer lodges an objection to the contract, then terminates the contract and asks for her money back. Seller (a good client) separately tells you the objection was not reasonable, and wants you to pay the deposit to him. As Escrow Agent what do you do?

- **Your duties are owed to both parties**
- **You may not decide who gets it; not your role as escrow agent**
- **Duty to disclose the dispute to both parties – *but not to give advice...***
- **Seek further instructions from both parties – *not just from your most important client...***
- **If you reach an impasse, are there other options available?**



III. What to do in case of an Escrow Dispute

Read the contract to see if it tells you clearly what to do

Typical TREC Contract: Paragraph 18 – Escrow

Earnest Money is deposited with Escrow Agent (EA) with the understanding that the EA is **NOT**:

- a. a party to the contract and is not liable for either party's performance;
- b. liable for interest payable on the deposit
- c. liable for any loss of earnest money due to failure of Financial Institution where deposited unless that Financial Institution is acting as Escrow Agent



III. What to do in case of an Escrow Dispute

TREC Contract: Paragraph 18 – Escrow

Demands by both parties: EA can require your unpaid expenses be paid and get a release from both parties.

Only one side demands payment: EA must give the other party(s) **notice** of the demand by sending a copy of the demand by certified mail.

- If the EA does not receive written objection to the demand after the notice within the time specified in the contract, (ex., 15 days), the EA may disburse the earnest money to the party making the demand, reduced by the unpaid expenses incurred for that party and may pay the same to the creditors.

IF the EA complies with the provisions of Paragraph 18, each party releases the EA of any claim related to the disbursement of the earnest money... IN A PERFECT WORLD...



III. What to do in case of an Escrow Dispute

What to do if you are at an impasse: Interpleader Action

TRCP 43: If Escrow Agent receives multiple claims to funds in its possession, it can file an *interpleader action* joining all claimants in one lawsuit and tender the disputed funds into the court registry.

Requirements to start an Interpleader Action:

- 1) EA is subject to or has reasonable grounds to believe rival claims exist as to the same funds;
- 2) It has not unreasonably delayed filing the interpleader action;
- 3) Tenders the disputed funds into the court registry.



III. What to do in case of an Escrow Dispute

Interpleader Action – TRCP 43

Advantages

- 1) Allows EA to avoid multiple liability as innocent stakeholder
- 2) Once funds deposited in court registry, EA is dismissed from the suit allowing the parties to slug it out in court.
- 3) EA can recover its reasonable attorneys fees from deposited funds at the discretion of the court

Disadvantages

- 1) Starting a lawsuit is expensive, involves attorneys
- 2) Is not exactly customer friendly; they'll remember what you did for years after



III. What to do in case of an Escrow Dispute

Lessons Learned

As Escrow Agent, you cannot take sides or solve their problem for them - get both parties written instructions and releases.

Rely on the contract terms but only if you are very sure about it...

Interpleader a last resort when you reasonably know the dispute will not resolve.

Consult your own company's attorney before you act. You can comply with the terms of your agreement (if you have one, like TREC) and still get sued!

Coming Soon: TREC looking at drafting better provisions for their contracts to deal with this situation.



IV. Escheatment - What to do with Abandoned Escrow Money

- Dates back to old days of civilization when all property owned by the king
 - All unused property forfeited back to the king.
 - In America, generally private property owned by the people
- In many states, abandoned or unclaimed property is required to be *escheated*, or sent to be held by the government **in trust** until the rightful owner can be found
 - If found, the rightful owner gets the property back
 - If not found, the government can sell it to a new owner as trustee for the people
 - Texas follows this “State as Trustee” escheatment model



IV. *Escheatment in Texas*

Generally, when Property has been held by a 3rd Party for **3 years** without demand by the true owner (“Unclaimed”), the holder is required by law to send it to the State.

- **Unclaimed Property** is anything of value that appears to have been abandoned/unclaimed by the owner for 3 years or more **AND** the owner’s whereabouts are unknown **AND** the property/money has been inactive on the books of the company holding it for the 3 year period.
- State Comptroller will run newspaper/internet ads on its holdings, seeking true owners to come forward to claim abandoned/unclaimed property
- Failure to turn over assets or money to the State so it can find the rightful owner can mean penalties by the State:
 - **Value of the asset, plus 10%**



IV. Escheatment in Texas

What does this have to do with title and escrow?

If you are still holding **escrow money** from a transaction that is 3 years old or more, unless you have a very good reason to keep it on account, you must report and turn over the money to the State as trustee for the rightful owner or face penalties



IV. *Escheatment in Texas*

What does this have to do with title and escrow?

- Must set up and keep an **Escheat Account** – a separate account for unclaimed money/property due an insured who cannot be located. Money has to be kept safely for 3 years and then reported to the State Treasury.
- **Keep copy of Escheat Account in your examination file** for review by TDI. Holders are required to retain the files on unclaimed property **for 10 years** from the date on which the property is reportable to the state.
- Must show you made an **attempt to find the owner** – usually by letter to last known address under your file information



IV. Escheatment in Texas

When do you have to report and pay over the unclaimed money?

Property Code, Sec. 74.1011 et. seq.

- **Notices:** Holders who on **March 1**, hold presumed abandoned property valued at more than \$250 shall mail a notice on or before the following **May 1** to the last known address of the known owner.
- **Reports and payments** to State are due on or before **July 1** of every year for holders who as of March 1, hold property presumed abandoned or unclaimed.

So your cutoff date for reviewing your records is **March 1** of every year; notify the owners of presumed abandoned property by **May 1**, and report and pay to the state on or before **July 1** to avoid penalties.



IV. Escheatment in Texas

Audits include examining Unclaimed property. Why?

Funds that are being **misappropriated** often find their way into Escheat Accounts, so appropriate auditing procedures must be performed on these accounts.

State (TDI) can audit your files and accounts to see if you are following their requirements on unclaimed property

- They will ask to review all files and accounts where property or money is held for 3 years or more.
- You will be required to show efforts made to notify owner(s), to justify your keeping the money and not reporting it to the State



IV. TDI Escheatment Requirements

TDI Exhibit E-1. All credit balances open three years or longer must be explained in detail on Exhibit E-1 disclosure.

- Must include detailed information regarding guaranty files which have been open for **three years or longer**. Information must include the reason the file is still open, such as "disputed earnest money," "funds escrowed for repairs," "error at closing," etc.
- Must indicate if a file is **active or inactive**. If a file is inactive or has been dormant for more than three years, the escrow agent should consider clearing the file via escheat or through the interpleader process.
- Individual guaranty files with dormant balances of **\$200 or less** may be reported in the **aggregate** for each specific reason the balances remain in the files.



IV. Escheatment - Example

Title company received \$4000 earnest money under contract and opened the file on June 30, 2015. Title Company checks its files by March 1, 2016 and finds deposit; sends certified letters requesting instructions and included Releases of earnest money to the buyer, seller and broker on April 30, 2016.

On May 15, 2016, the seller claims the money by telephone conversation that was noted in the file. On June 1, 2016 title company received a letter from the buyer demanding the money. No further communication is received regarding any settlement by both parties on their money claims.

We recommend you send a second letter to the parties by March 1, 2018. On or before July 1, 2018 you should report and deliver to the State as Trustee – if you do not receive instructions and releases from buyer AND seller.

Interplead the funds? What about 4 year S/L on the dispute?



V. Scheduled Disclosures – Seeking Transparency

Commitment Disclosures - Texas Title Information Sheet

- Explains the Commitment generally, the title insurance process and the basic effect of the policy by and through the requirements, exceptions, exclusions and conditions.
- Explains no mineral interests are covered and generally explains possible endorsements (alluding to, but not referring specifically to the T-19 Endorsement)
- Information on common policy options such as getting “survey coverage” and deletion of the “parties in possession” exception.



V. Scheduled Disclosures - Commitment

Texas Title Information Sheet - Complaint Notice

- Notice is given about assistance that is available to the proposed Insured from both the Underwriter and the Texas Department of Insurance (TDI)
- Includes the Underwriter's and the Department of Insurance's toll free numbers in case the proposed Insured wants to make a complaint



V. Schedule “D” Disclosures

Commitment Schedule D- WHY? *TDI Procedural Rule P-21, Rate Rule R-1*

P-21, R-1 require pre-closing disclosures on

- **Who owns** large portions (> 10%) of the *Underwriter*, unless the Underwriter is publicly traded or is wholly owned by a parent that is publicly traded holding company; Names of the directors and the executive officers of the Underwriter.
- **Names of those who own** > 1% of the *Issuing Agent* that will get some portion of the premium (and those that own > 10% of the owning entity of Agent); Names of directors and executive officers if Agent is a corporation
- Names of those **third parties getting portion of the premium** for services performed and the estimated amount of premium to be received as per R-1
- Breakdown of settlement **charges** and estimated **premium payable**, and to whom the premium is being paid out – Underwriter, Issuing Agent and Third Parties



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Be Careful Out There

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Join us for the next Texas TIPS webinar!

December 21, 2017

TDI Enforcement Actions and How To Avoid Them

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